



THE FIRST REPORT ON THE DELAWARE STATE TREASURY

*Submitted to the
People of the State of Delaware*

FEBRUARY 14, 2011

BY STATE TREASURER CHIP FLOWERS

The State Treasurer, in accordance with a mandate inherent in his constitutional duty as steward of public funds, deems it necessary and proper to submit a report to the People of the State of Delaware informing the citizenry of the condition of their treasury (the "People's Treasury").¹ In preparing this First Report on the Delaware State Treasury (the "Report"), the State Treasurer and his administration have taken due care in considering the great challenges facing our state finances in this period of economic turmoil.

As we emerge from this turmoil, the pivotal question standing before us is whether the People's Treasury, humbled by our past economic hardships but strengthened by the wisdom of experience, will emerge stronger in this new era of unrivaled challenges and unprecedented opportunities.

The condition of the People's Treasury, the cornerstone of Delaware's financial system, is a key determinant of our economic future. A strong treasury, backed by the full faith and credit of the People, is a powerful tool in restoring our economic prosperity. Conversely, a weak treasury, bound by artificial limitations, will fail to gain the necessary traction to utilize our financial assets to enhance the well-being of our state.

As noted in the Flowers Framework for Restoring Prosperity (the "Framework") proposed nearly a year ago, the contents of any written work are "treated imperfectly." This Report is not exempted from this maxim, as ample discussion and debate will often improve new ideas intended to strengthen our state. However, this discussion and debate should not cripple our ability to revamp the People's Treasury to enhance our economic destiny in today's 21st century global economy. In this new era, the old rules and ways of viewing the role of our state government, in particular the Delaware State Treasury, will paralyze our ability to succeed. We must not fear new ideas and change; rather, we must embrace these concepts with openness and caution, while united by the common purpose of restoring our economic prosperity.



Delaware State Treasury

State Treasurer Chip Flowers

Using the constitutional powers vested into this treasury and a true conviction in the moral cause of prosperity for all, it is the State Treasurer, representing the collective financial interest of the People and the state, who must be willing to summon the strength of the electorate in this passing moment of economic turmoil to move the Delaware State Treasury toward our common purpose. Without question, this task has its obstacles and challenges. Regardless, this Report seeks to establish a new role, having received the consent of the People, for our treasury.

This Report is divided into two parts: (i) the state of the People's Treasury and (ii) new initiatives of the People's Treasury. In preparation of this Report, I humbly request that the People remember that this charge was undertaken during the initial 30 days of my entering public office. With this in mind, our discussion shall commence with the state of the People's Treasury.



STATE OF THE PEOPLE'S TREASURY

With each day, the state of the People's Treasury becomes stronger as new reforms and initiatives are undertaken to better utilize our financial resources to restore economic prosperity to Delaware. As Delawareans have done for generations, the State Treasurer and his administration seek to build upon the foundation laid by our predecessors while redefining the critical role of the People's Treasury within the constitutional framework of our state government.

It is the belief of the State Treasurer that good governance requires a frank and candid dialogue with the People and their representatives. The result of the dialogue will serve as the building block for restoring our economic prosperity to those being governed. In evaluating the state of the People's Treasury, it is important to note a few of the major strengths and deficiencies evidenced during the initial 30-day review period. It is in this spirit that the State Treasurer seeks to begin this frank and candid dialogue about the People's Treasury:

◆ STRENGTHS OF THE PEOPLE'S TREASURY

Strong Personnel

The employees of the People's Treasury, though only 23 in number, represent the best attributes expected from individuals who dedicate their lives to public service. The individuals serving the People's Treasury are significantly underpaid (as compared to their private sector counterparts) and as a result of continual downsizing, perform multiple job responsibilities that may or may not be in their fields of expertise. Despite lower pay, a shortage of workforce and limited opportunities for internal promotions, these public servants not only perform their daily duties beyond expectation, but have embraced the idea of a revamped treasury designed to restore economic prosperity. Without question, the strong personnel of the People's Treasury are an important asset that has allowed this constitutional office to serve as the cornerstone of the state's financial system.

Financial Practices

The People's Treasury continues to engage in sound financial practices that have not only protected Delaware's AAA bond rating² during our current economic cycle, but have also resulted in efficiencies by reducing the cost of processing payments to state vendors and personnel (i.e., decreasing the number of checks processed and issued through the treasury). Practicing sound financial policies enables the People's Treasury to allocate resources efficiently in monitoring and managing the financial operations of the state. These strong financial practices provide the foundation for preparing the People's Treasury for a 21st century global economy.

²As of the date of this Report, Delaware is one of only eight states with the coveted "AAA" bond rating for purposes of issuing state debt instruments.



Delaware State Treasury

State Treasurer Chip Flowers

Customer Service

The backbone of any financial organization interacting with the People is its ability to deliver high-quality customer service. The People's Treasury, in performing critical financial services for Delaware, has garnered a reputation for providing a high level of customer service to the People (including those intergovernmental agencies that require state financial services). Restoring our economic prosperity requires a smooth and predictable stream of payments within the state financial system. Having a high-quality customer service operation ensures that such payments are transferred properly and that required revenue enters the system in a reliable manner.

Financial Education Initiatives

One of the primary causes of our current financial crisis was the lack of financial knowledge among Delaware families prior to making major decisions that would substantially impact their livelihood. Preparing the next generation of Delawareans to meet the financial challenges of our times is an important goal of the People's Treasury. Though the financial education initiatives will require retooling to provide the necessary level of support to our small businesses and entrepreneurs, the existing education initiatives sponsored by the People's Treasury help families by equipping them with the financial tools to evaluate those opportunities that will impact their livelihood.

◆ DEFICIENCIES OF THE PEOPLE'S TREASURY

Vision & Mission

Upon the State Treasurer entering the People's Treasury, the vision and mission of the office were not tailored to meet the challenges required of a 21st century financial organization. The prior vision and mission, though relevant for earlier times, no longer captures the essence of the People's Treasury's role in the modern era. The People's Treasury requires a vision and mission that seeks to inspire our public servants to heed the urgent call to engage in the critical financial and economic aspects of our state government. Without a strong vision and mission, our treasury lacks the required level of focus to restore economic prosperity to the First State. As discussed in the next section, the vision and mission of the People's Treasury has been changed to reflect the revamped nature of this important constitutional office within the framework of our state government.

Organizational Structure

Similar to the discussion regarding the prior vision and mission of the People's Treasury, the organizational structure in effect upon the State Treasurer entering public office did not allow the People to understand the complex operations of their treasury. As a result of this unclear organizational structure, confusion about the role of the People's Treasury has continued through successive administrations. This confusion must end. The People's Treasury, tasked with significant functions that impact the daily lives of Delaware citizens, must have a clear organizational structure to provide the business community and the general public with sufficient information to interact with its internal offices. To accomplish this objective, as discussed in the next section, the organizational structure has been changed to reflect the functions and operations of the treasury.

Relationship with the Delaware Business Community & External Financial and Economic Agencies

Presently, the People's Treasury does not have strong and substantive relationships with key external financial and economic agencies. This has resulted in uncoordinated actions to stimulate economic growth in Delaware. In our 21st century global economy, it is imperative that the People's Treasury foster and promote strong relationships with external financial and economic agencies to ensure that consistent and collaborative economic policy is promoted throughout the state.



Delaware State Treasury

State Treasurer Chip Flowers

Use of Financial Assets for Economic Growth

In response to the current economic crisis, the People's Treasury must adopt an investment strategy that protects our taxpayer dollars while simultaneously directing such dollars toward investment opportunities within Delaware. Currently, the state's investment strategy does not require a significant amount of state funds to be invested within Delaware, thus failing to use state resources to stimulate economic growth. As a result, Delaware is faced with a lack of sufficient capital for small businesses to invest in our communities. Our AAA bond rating provides a lower borrowing rate when the state needs to issue debt; however, we must not forget that the ultimate goal of our state financial system is to implement a safe and robust investment strategy that would limit the amount of debt issued on an annual basis. We must make prudent investment decisions that would spur economic growth and potentially reduce our debt burden.

Insufficient Number of Personnel

With state government personnel totaling in excess of 30,000 employees, only 23 treasury employees (less than .08% of our total workforce) manage a daily portfolio of approximately \$1.5 billion. Critics seeking to attack the size of our state government fail to recognize that governments, like any organization, are flexible instruments that must adapt with the changing tide of our economy. The total size of our workforce is not the accurate measure of whether our state government is operating efficiently; rather, evaluating the size of individual agencies and departments to determine their individual needs is more appropriate. Additional personnel are needed to continually monitor and analyze the state's investments and economic activity and to assist the State Treasurer in performing the constitutional duties and responsibilities. To further evidence this point, without the State Treasurer donating his after-tax salary to fund two fellowship positions, the People's Treasury would have lacked sufficient resources to draft, develop and deliver this Report. It is important to note that the treasury, if properly staffed and managed, is an arm of the state that provides revenue to the state coffers in excess of its operating costs.

State Accounting Program

The hours and costs currently spent by the People's Treasury addressing critical issues and problems with the new state accounting system are unsustainable. With limited staff to perform its constitutional duties, the People's Treasury must have an accounting system capable of performing basic and necessary functions without issue. Currently, the state accounting system is causing serious reconciliation issues and is creating inefficiencies within the People's Treasury that were non-existent prior to its implementation. Accounting technology improvements should not serve as a barrier to productivity; rather, the People's Treasury must have an accounting system that increases productivity and reduces inefficiencies in processing payments. The treasury commends the Department of Finance and its staff (particularly, its Secretary) for recognizing these issues and working to resolve these problems expeditiously.

Technology

Upon the State Treasurer entering the People's Treasury, the technology was insufficient to meet the requirements of a 21st century financial office. For example, as of January 2011, the People's Treasury owned only one small analog television (not connected to cable or satellite) as its primary mechanism (other than the Internet) to monitor news, the financial markets and other key economic activity. This is an example of the many technological challenges that were impeding the ability of the People's Treasury to perform its constitutional duties at an optimal level. Furthermore, the People's Treasury did not own any proprietary software that provided real-time economic data on national and state market activity. While cost-cutting initiatives are important, managing a portfolio of more than \$1.5 billion in today's global economy with insufficient resources is unacceptable. To this end, initiatives relating to technology upgrades and access to real-time market information have been implemented. *(These initiatives are discussed in the next section.)*

Security

Due to the sensitive nature of the security measures employed by the People's Treasury, this section has been redacted and provided to members of the General Assembly's Joint Finance Committee.



NEW INITIATIVES OF THE PEOPLE'S TREASURY

In furtherance of, and pursuant to, the Framework, which was submitted for approval by the People prior to the State Treasurer entering office, this Report recommends adoption of the following initiatives by the People's Treasury:

Implement a 21st Century Mission (Completed)

In January 2011, the People's Treasury enacted a new mission that addresses the proper constitutional role of this office.

The new mission of the People's Treasury, the cornerstone of the state's financial system, is to restore economic prosperity to the First State by providing critical financial services for the People of Delaware.

Under this new mission, the State Treasurer and his administration are confident that the People's Treasury will play a pivotal role in (i) managing the state's financial system and (ii) restoring our economic prosperity.

Create the Office of Economic Policy (Completed)

The People's Treasury must have sufficient information prior to making key financial and economic decisions. To fill this void, the People's Treasury has created the Office of Economic Policy ("OEP"). OEP is tasked with developing and promoting innovative initiatives that will assist in restoring prosperity. Additionally, OEP will provide independent and nonpartisan economic guidance and analysis with respect to Delaware's economy. Finally, OEP will produce the Delaware Economic Index and implement the Delaware Early Warning System (both discussed later in this section). In doing so, OEP will act as a hub of economic information to inform the public of our state's economic condition. OEP has been created without expense to taxpayers.

Create an Office of Finance and Treasury Services (Completed)

To achieve economic growth and job creation in the 21st century, the People's Treasury must have a strong presence in identifying financial and investment opportunities that stimulate economic growth. The Office of Finance and Treasury Services ("OFTS"), derived from existing resources within the People's Treasury, has been created to manage the state's investment portfolio and develop short- and long-range investment policies that will protect taxpayer dollars and assist in the common purpose of restoring our economic prosperity. OFTS will interact directly with public and private sector leaders to advance investment positions that will benefit the state (including, but not limited to, protecting the state's AAA bond rating). OFTS has been created without expense to taxpayers.

Implement the Delaware Economic Index and the Delaware Early Warning System (Completed)

As the cornerstone of our state's financial system, the People's Treasury must present the public with relevant economic data to better inform the electorate of the state's current economic climate. To accomplish this goal, OEP is publishing a periodic index, entitled the "Delaware Economic Index," which is issued every 60 days. This index serves as the basis of the Delaware Early Warning System, as the index provides a color-code system that identifies the historical trend of our state's economy. Since economic downturns can occur at any time, having a formal financial early warning system is essential. At any point, based upon real-time data and information, OEP can adjust its evaluation of our state's economic position and notify the People. By presenting relevant and timely economic data and information, the index and early warning system can assist Delaware businesses, as well as the public at large, in making informed financial decisions with respect to the current economic climate.



Delaware State Treasury

State Treasurer Chip Flowers

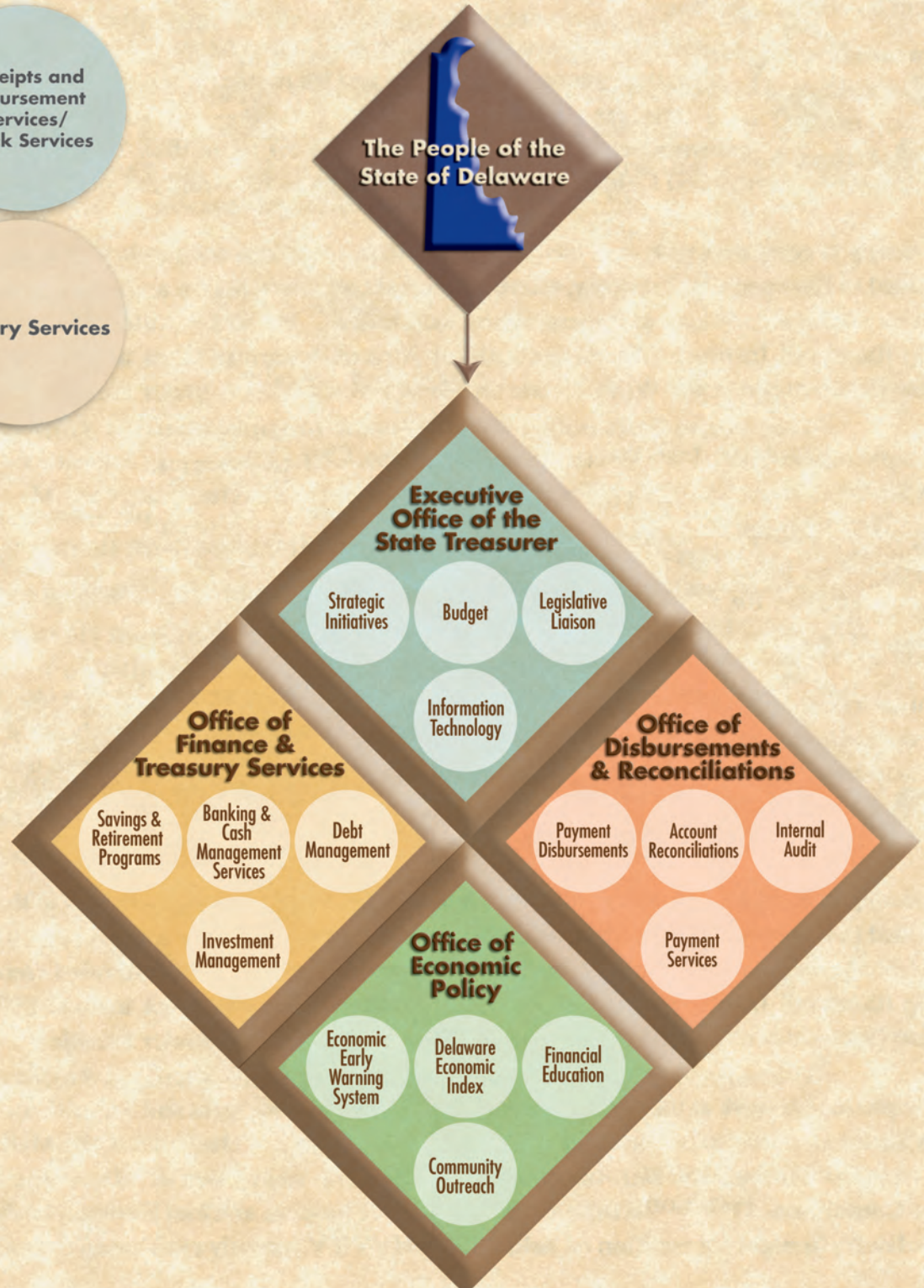
Create an Effective and Transparent Organizational Structure (Completed)

To effectively perform the duties in furtherance of the mission of the People's Treasury, a clear transparent organizational structure must be in place. As such, the People's Treasury has created a new organizational structure that clarifies the functions of this important financial office. Below is a chart depicting the prior and new organizational structures of the People's Treasury:

PREVIOUS ORGANIZATIONAL STRUCTURE



NEW ORGANIZATIONAL STRUCTURE



The new structure clarifies and reflects the various roles of the People's Treasury to the public within our constitutional framework.



Delaware State Treasury

State Treasurer Chip Flowers

Create a New Name for the People's Treasury

It is instrumental that the name of a government office focuses on the services that the office provides to the People, not the elected official serving as the head of such office. While political considerations make it desirable to name state offices in a manner that highlights the officeholder, it is more appropriate to emphasize the function that such office provides to the People. To this end, this Report recommends that the Office of State Treasurer be renamed the Delaware State Treasury.³ This name change is beneficial as it is in line with comparable names used by those offices in our fellow states having similar functions and responsibilities and adds significant stature to the important financial and economic policies issued by the People's Treasury.

Increase Security Measures for the People's Treasury

Due to the sensitive nature of the proposed security measures for the People's Treasury, this section has been redacted and provided to members of the General Assembly's Joint Finance Committee.

Implement a Small Business Investment Program

As a vehicle for job creation in Delaware, small businesses are an important component of our economic growth. Due to current tight lending standards, however, many Delaware-based small businesses are unable to obtain the capital necessary to expand their operations and increase their payrolls. To ease credit limitations in our state's lending market, this Report recommends the People's Treasury implement the Delaware Small Business Investment Program (the "Small Business Program"). Generally, the Small Business Program will diversify the state's investment portfolio by increasing the number of financial institutions permitted to hold state funds and depositing such funds in only those financial institutions that are safely lending to Delaware small businesses at or above a target level (such level shall be determined based upon economic activity). The Small Business Program seeks to increase lending to small businesses to spur economic growth and job creation without placing state dollars at additional risk.

Create the Economic Targeted Investment Program

Our current investment guidelines promote security of principal, liquidity and return on investment. This conservative approach to investing the public's money is correct and proper. However, as a steward of public funds, the People's Treasury has a duty to ensure that taxpayer dollars are invested in Delaware businesses. To serve this duty, this Report recommends the creation of an Economic Targeted Investment Program (the "ETI Program"). Under the ETI Program, the People's Treasury, with the assistance of financial institutions, will invest state funds in safe financial instruments that underlie Delaware projects. With roughly \$1.5 billion under management, the People's Treasury has the ability to influence the state's economy through targeted investments in financial instruments that support Delaware projects. By targeting a portion of these state funds under the ETI Program, the state's investment portfolio can serve as a tremendous asset in restoring economic prosperity to the First State.

Develop a Marketing Outreach Program Focused on Savings, Investments and Entrepreneurship

To assist Delawareans in investing in their personal financial future, the People's Treasury will develop a marketing outreach effort to encourage savings, advocate for sound investments, and promote entrepreneurship. This marketing outreach effort will build upon programs currently offered by the People's Treasury for the benefit of state employees. As a constitutional office tasked with serving all of the People, the new program will be broadened to reach Delawareans at large, particularly in these difficult economic times when there is a premium on sound financial information and advice.

³It should be noted that the name of this Report reflects the new name of this office.



Delaware State Treasury

State Treasurer Chip Flowers

Modernize the People's Treasury

Utilizing technology and financial information is critical to managing the state's investment portfolio in the 21st century. Since January 2011, the State Treasurer and his administration have undertaken a major initiative to modernize the People's Treasury to fulfill the constitutional and legislative mandates in furtherance of its mission. New technology (including hardware, software and technical resources) has been put in place to ensure that our modern treasury is agile and productive. Additionally, wireless network capabilities and portable computing devices shall be deployed over the next few months. Furthermore, the People's Treasury is preparing to implement a comprehensive financial software solution to provide our state's investment team with critical access to real-time financial and economic data and information. Finally, the People's Treasury is working with the state's Government Information Center ("GIC") to update its website to increase user friendliness, promote greater transparency, and provide relevant Delaware economic information to the People.

Reduce the Number of Checks Issued

The People's Treasury has significantly reduced the number of checks processed and issued over the past few years, and will continue to make additional reductions in the future. For fiscal year 2011, the treasury is currently on pace to decrease total checks processed by 22% from the previous fiscal year, which would save the state significantly in processing and issuing costs. The People's Treasury, with the assistance of the General Assembly, will work with state agencies and vendors to further reduce the number of checks issued to maximize savings while maintaining optimal service. Furthermore, the People's Treasury will work with the General Assembly to establish a timeline to eliminate the issuance of checks over the next few years, with limited exceptions.

Establish and Improve Relationships with Federal Agencies

In an increasingly complex and interdependent world, it is vital that the People's Treasury establish strong ties with key federal agencies tasked with issuing financial and economic policies. These relationships enhance Delaware's voice in national and regional policymaking venues. The ability to influence economic policymakers on major decisions impacting Delaware is a necessary component to restoring our economic prosperity. It is important for the People's Treasury to meet regularly with members of the U.S. Treasury Department, the Federal Reserve Bank and other key federal agencies to discuss programs and policies that could impact the fiscal health of our state. As the People's Treasury seeks to address today's economic issues in Delaware, it is of critical importance that we foster a cooperative relationship with the federal government and its agencies. Working in cooperation, we can meet today's global challenges united in the common purpose of restoring our economic prosperity.



CONCLUSION

The State Treasurer, upon careful consideration of the matters set forth herein, has detailed the state of the People's Treasury. This Report is humbly submitted to the People of the State of Delaware for proper consideration.

A special note of gratitude to the following contributors to this Report:

Ms. Erika Benner, Deputy State Treasurer
Mr. Brian Boyle, Fellow
Ms. Kelly Callahan, Special Assistant
Ms. Lonni Lehman, Designer

Mr. Omar Masood, Fellow
Mr. Larry Nagengast, Senior Advisor
The Staff of the Delaware State Treasury